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No. 89-1659

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1989

WILLIAM H. SCHNEIDER, et al.,
Petitioners,

VS.

APPLE COMPUTER, INC., et al.,
Respondents.

Petition for Writ of Certiorari to the United States Court of Appeal for the Ninth Circuit

PETITIONERS' REPLY BRIEF IN SUPPORT OF CERTIORARI

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I.

INTRODUCTION

Respondents' Opposition to the Petition for Writ of Certiorari ("Opp.") underscores the need for issuance of the writ. The Opposition substantially admits that the Ninth Circuit has rewritten the law of materiality in securities fraud, establishing a new double standard in contravention of *TSC Industries v. Northway,* 426 U.S. 438 (1976), and *Basic, Inc. v. Levinson,* 485 U.S. 224 (1988). Moreover, instead of separately defending the Ninth Circuit's two ostensibly independent holdings, Respondents present a wholly circular analysis that rests each holding upon the other.

Thus, for example, to explain the Court of Appeals' holding regarding materiality, Apple falsely asserts that this "case is not about affirmative 'lies'," and that "there is no claim that Apple was not genuinely optimistic about Lisa." Opp. at 2. To the contrary, stating that "I don't think we will have any trouble selling all the Lisas we can build" *is* alleged to be a lie, and was made at a time when the record reflected that Apple was not nearly that optimistic about Lisa. Not surprisingly, in defending the Ninth Circuit's finding of no scienter, Apple relies upon the implicit assumption that the statements were immaterial, thus completing the circle.

At bottom, both materiality and scienter presented jury questions, and it was only by misconstruing the substantive securities law that the Ninth Circuit could resolve them on summary judgment. Moreover, Respondents' repeated assertion that the rulings below are "fact specific," Opp. at 2, is nearly correct; the issues below were factual, and could only be resolved on summary judgment by misconstruing Fed.R.Civ.P. 56 and this Court's summary judgment "trilogy."

II.

THE DECISION BELOW CONFLICTS WITH *BASIC* AND *TSC INDUSTRIES* BY CREATING A NEW DOUBLE-STANDARD OF MATERIALITY

In *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), this Court established an *objective* test of materiality for securities fraud cases. "The question of materiality, it is universally agreed, is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor." *Id.* at 445. This Court held that a fact is material under the securities laws "if there is a substantial likelihood that a *reasonable shareholder* would consider it important .... Put another way, there must be

a substantial likelihood that the disclosure of the omitted fact would have been viewed by the *reasonable investor* as having significantly altered the 'total mix' of information made available." *Id.* at 449 (emphasis added).

In our petition, we urged (in question 2) that the Ninth Circuit had established a double standard of materiality, with an entirely new test, inconsistent with *TSC Industries,* for fraud on the market cases. Petition at 19-20. Although Respondents purport to dispute this assertion, Opp. at 8, with the next breath they admit that the decision below *does* create a different standard of materiality for fraud on the market cases. They explain: *"The difference (compelled by the fraud on the market theory) is the relevant audience* to whom the ' "total mix" of information [is] made available': in face-to-face cases, the individual investor; in fraud on the market cases, the market itself." Opp. at 8 (emphasis added).

But this is nonsense. As the materiality test is *objective,* focusing upon *the reasonable investor,* materiality must be the same in an individual case involving direct reliance and in a fraud on the market case. In both circumstances, the materiality question under *TSC* is whether a reasonable investor might find the omitted or misstated information to have altered the "total mix," and the "total mix" of course reflects the very "market" to which respondents advert. Because the test is objective, it cannot vary with the audience, and the Ninth Circuit has badly misconstrued *TSC* and *Basic.*

That the Ninth Circuit adopted a new test of materiality at variance with *TSC* is quite clear. The Court recognized that Respondents' statements were misleading, and suggested explicitly that they would be actionable in anything but an action asserting fraud on the market. The Court wrote:

> Ordinarily, omissions by corporate insiders are not rendered immaterial by the fact that the omitted facts are otherwise available to the public. [Citations omitted]. Where a plaintiff alleges actual reliance on a particular statement, it does not matter that the *market* is aware of the facts necessary to make the statement not misleading. The plaintiff may be misled . . . .
>
> *The situation is different in a fraud on the market case.*

Petitioners' Appendix ("App.") at 8a (emphasis added). The Ninth Circuit went on to say that "[a]lthough many of these statements *failed to disclose material risks,*" and hence were *material* under the test of *TSC Industries,* "we agree with the trial court that there are no genuine issues of fact *under a fraud on the market theory.*" App. at 12a (emphasis added).

Contrary to Respondents' contentions, this double-standard of materiality *is not* "compelled by the fraud on the market theory," Opp. at 8, much less by this Court's holding in *Basic.* Indeed, *Basic* applied the *TSC* objective standard of materiality to a fraud on the market case. Thus the court below applied a novel standard of materiality, and only by so doing, put itself in a position to resolve this incontrovertibly *factual* issue of materiality *as a matter of law.*

Apple's other arguments to avoid *certiorari* on the materiality holding do not hold water.

— The fact that other circuits have cited *Apple,* Opp. at 9, for one point or another does not mean that they agree with the holdings challenged here. Indeed, we submit that

the panel decision in *Backman v. Polaroid Corp,*[1] is in conflict with *Apple,* holding that questions similar to those resolved here on summary judgment were proper questions for the jury. Similarly, the Seventh Circuit's general citation to *Apple* in *Wielgos v. Commonwealth Edison Co.,* 892 F.2d 509, 516 (7th Cir. 1989), does not undercut the fact that the crucial holding in *Apple* is inconsistent with the Seventh Circuit's treatment of that issue in *Flamm v. Eberstadt,* 814 F.2d 1169 (7th Cir.), *cert. denied,* 484 U.S. 853 (1987).

— Apple's assertion that it is "too soon for the Court to revisit what it said in *Basic,*" Opp. at 5, misses the point. Petitioners do not seek reconsideration of *Basic*; we seek consideration of a new definition of materiality, and a new defense to "excuse" fraud, which the Court of Appeals erroneously drew from this Court's decision in *Basic.* These are important questions which merits this Court's prompt attention.

The materiality question and the new defense created by the decision below are important cutting edge questions of securities law worthy of *certiorari.*

III.

THE NINTH CIRCUIT'S SUMMARY JUDGMENT ON SCIENTER IS INCONSISTENT WITH RULE 56, FED. R. CIV. P.

The Ninth Circuit also held that Respondents' objectively misleading statements were not actionable "be-

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[1]Docket Nos. 89-1171, 89-1172 (1st Cir. Jan. 23, 1990). Cited by Respondents at 893 F.2d 1405, *Backman* was withdrawn from publication for rehearing *en banc,* and does not appear in hardbound volumes of the *Federal Reporter.*

cause there is no rational basis in the record for concluding that any of the challenged statements was made with the requisite scienter."[2]

Summary judgment on this issue reflects a serious misconstruction of the securities laws or Rule 56. Given the record, which the Court of Appeal acknowledged showed that "Lisa's prospects were *uncertain,*" App. at 15a, how can Apple say "Lisa is going to be phenomenally successful in the first year out of the chute," and obtain a finding of no scienter as a matter of *undisputed* fact. (Statement 8). Plaintiffs submit that whether these statements were made in good faith must be a jury issue — especially where the insiders were selling their own shares while they misled the market, and the stock collapsed when the company finally revealed the truth.

The record reflects Respondents' knowledge throughout the class period that both Lisa and Twiggy suffered serious deficiencies that ominously threatened both the products' success and Apple's profitability. Indeed, even before the Class Period began, early test marketing of Lisa had demonstrated that potential customers were not enthusiastic about the machine, and that among those prospective purchasers who actually *tested* Lisa "reactions to Lisa were overall, disappointing." ER 7:462-3, 468. Apple, of course, never disclosed that consumers who actually used Lisa did not care for the machine. Instead, Respondents built a public relations compaign that consistently represented Lisa as a remarkable success.

The situation got progressively worse, as Lisa became more obviously troubled (ultimately hopeless), while Apple continued to falsely assert that everything was fine.

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[2]App. at 14a. Scienter, of course, includes recklessness. *Id.*

On this issue, respondents' opposition is nothing more than a restatement of its factual defense regarding scienter. This approach should not distract this Court from the fact that the District Court and the Court of Appeals badly misconstrued this Court's precedents on summary judgment to deprive plaintiffs of a jury trial on scienter.

IV.

RESPONDENTS ACKNOWLEDGE THAT THE NINTH CIRCUIT'S OPINION DECIDES FACTUAL ISSUES WHICH GENERALLY MUST BE LEFT TO THE JURY

Respondents contend that this Court should not review the Ninth Circuit's grant of summary judgment because "[t]hese rulings are *intensely fact specific.*" Opp. at 2. It is precisely because these were intensely disputed *material questions of fact* that the Ninth Circuit erred in its reading of Rule 56 on motion for summary judgment. Respondents' contention that this legal error is a reason *not* to grant certiorari is truly remarkable. They assert that because materiality and scienter present intensely factual questions — as to which they admit that summary judgment is seldom appropriate, Opp. at 12 n.11; 20 n.16 — "[c]ertiorari is not warranted on these fact specific issues." Respondents thus contend that if a court errs in its interpretation and application of Rule 56, its error should be immune to review by this Court.

Serious error in the application of summary judgment standards is appropriate for review by this Court. This is particularly true in this case where the misinterpretation of this Court's summary judgment precedents also does so much violence to the substantive law under the Securities Exchange Act of 1934.

Respondents also argue that the summary judgment issues should not be reviewed because the Court has "recently spoken" through the "trilogy." Opp. at 5. Four-year-old cases, two decided by 5-4 majorities, which have generated much controversy, *see* Petition at 27 & n.28, are not the type of settled law which should not be revisited or clarified in the proper case.

V.

CONCLUSION

The petition should be granted on all three questions.

DATE: June 4, 1990

Leonard B. Simon